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IN DEPTH: BOARD GOVERNANCE

Resisting the 'siren song' in the interests of your client

Lawyers shouldn't read more into Sarbanes than what Congress intended

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Earlier this year, this newspaper carried an article titled, "Sarbanes-Oxley to rewrite HR's job description." The article was about a timely subject, touched on a hot area that has raised a lot of questions -- and was replete with misinformation.

One cannot blame the journalist who wrote the piece: She was merely summarizing what she had been told by human resource and legal sources. The errors espoused by these experts ranged from concluding that HR departments somehow have a "new role" to play with respect to blackout periods, to presuming that HR has any significant role with respect to executive compensation, and most egregiously, to advising that HR has a central role to play with respect to the generation or administration of a company's whistle-blower policy for accounting and auditing issues.

On one level, there is a beguiling logic that could easily distract a lawyer who does not recognize the subtle, yet crucial, changes in the law that Sarbanes-Oxley Act of 2002 mandated: Traditionally, employee complaints go through HR departments, and indeed, HR personnel are trained to handle such matters.

Further, Sarbanes-Oxley does not specifically disallow the HR department from handling complaints. The SEC states that no bright-line system must be followed by every company; rather, the audit committee should develop such procedures as to it seems most appropriate. Thus, theoretically, an audit committee could use its company's HR department in the process. What this ignores, however, is the law's repeated emphasis that the audit committee must develop, implement and oversee such policies so as to safeguard even the "appearance" of good governance.

Indeed, with respect to whistle-blower protection, the SEC is quite clear about the need to encourage and protect individuals who "may be reticent to report concerns for fear of management reprisal" by, among other things, guaranteeing confidential, anonymous submission by employees.

Many of those purporting to be experts characterize programs that achieve those goals as some sort of "best practice" corporate governance. This implies that there are levels of "good governance," the better forms of which may or may not be adopted by a corporation. Such a view might have been accurate if the SEC had actually prescribed rules, which it did not. The SEC requires compliance to principles. Thus, the question is not one of best practice versus minimal compliance; rather, the question is whether a corporation has achieved the goal that Congress and the SEC mandated.

Why, then, do the majority of "corporate governance practice groups" make such fundamental mistakes and misadvise their clients? We believe it is attributable to three root causes whose siren songs seduce most lawyers into a sense of complacency, ultimately leading to failure. In summary, these root causes are: the beguiling false security of early specialization; the outmoded, unenlightened obeisance to a client's individual advancement; and the tunnel-vision arrogance that former SEC chairman Harvey Pitt decried as "a form of professional blindness that isn't new."

Let us offer a few comments on each.

First, there is the call to early specialization. There are no HR problems for a business, just as there are no HR solutions. There are only business problems and business solutions, some of which may have HR issues involved to a greater or lesser extent. The business organism is an integrated whole with each of its aspects invisibly interrelating and affecting other aspects of the entity. Thus, a holistic and interdisciplinary approach is necessary when examining each business problem.

Carsten Kowalcyk of The Fletcher School regularly admonishes his students, "If you give a kid a hammer, the whole world becomes a nail." Early specialization by counsel thus serves as a governor on lawyers' engines of creativity to limit the way they look at problems in light of that specialty which is near and dear to them.

The remaining two sirens arise from the antiquated amorality that has characterized traditional legal practice. Modern business realities require lawyers to understand the consequences of their and their clients' conduct rather than to be enraptured with the call to a mere blind, zealous advocacy of their clients' positions. Whether it is the complexity attendant to Sarbanes-Oxley or the growth of globalization of business, lawyers need to learn a new diplomacy that uses language to communicate and heal fractures. Rather than merely taking an adversarial view of the law or of business partners by seeking to get "extra pieces of the pie" for their clients, they should work in an integrative manner to understand all principles and interests so that the "pie" may be made larger and better.

Finally, and most importantly, the move toward "principle-based" regulations over "rule-based" ones means that the lawyer and the client must use their creativity and initiative to serve those principles rather than using their acumen to heed the enticing call to circumvent the purposes of regulations while giving lip service to technical compliance.

In a system that is "rule-based," there are always gaps that clever practitioners may find that enable companies to accomplish that which the specific rules were not intended to permit. However, when the law mandates compliance with a principle, noncompliance with the principle amounts only to illegal noncompliance. As SEC chairman Pitt also stated in a speech last year regarding Sarbanes-Oxley, "Helping a company satisfy literal legal prescriptions ... doesn't satisfy a ... lawyer's duties." Moreover, only legitimate corporate interests may be pursued, "even if management's individual goals arguably are supported by a literal reading of the law."

Sarbanes-Oxley is only the most recent statement of principles that, in this country, have been repeated since the Treadway Commission's landmark 1987 report on fraudulent financial reporting. It is the result of the private sector failing, as it still fails to remedy the ills that have plagued us. And unless a new generation of lawyers comes to the fore that refuses to heed the song of these sirens of failure, we shall all be subject to the consequences of George Santayana's warning that "those who do not remember the past are condemned to repeat it."

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